

Internal Revenue Service
memorandum

date: DEC 5 1991

to: Assistant District Counsel
Indianapolis

from: Chief, Branch 5
(Employee Benefits and Exempt Organizations)

subject: Request for Technical Assistance - Noncash payment of
agricultural wages to avoid FICA taxation

This is in response to your October 10, 1991, memorandum concerning the use of noncash compensation as a planning technique to minimize payroll taxes for Indiana agricultural employers.

You describe two prototypical situations involving the use of agricultural commodities to compensate employees for their agricultural services. The first situation involves a farm corporation, formerly a sole proprietorship, which executes an employment contract with the shareholder/employee specifying that all the employee's wages for the year are to be paid in commodities. The second situation involves the sole proprietor of a farm who attempts to reduce his self-employment taxes by employing his spouse on the farm and paying a portion of her salary in live hogs.

During 1991 this office has received several cases involving the same fact patterns described above. The issue is whether agricultural employers may avoid FICA taxation under section 3121(a)(8)(A) of the Code by compensating their employees in agricultural commodities instead of cash. The following is a legal analysis of the issue.

Section 3121(a)(8)(A) of the Internal Revenue Code provides that, for purposes of the Federal Insurance Contributions Act (FICA), the term "wages" does not include remuneration paid in any medium other than cash for agricultural labor (as defined in section 3121(g)). A similar definition appears in the Federal Unemployment Tax Act (FUTA).

Section 31.3121(a)(8)-1(f) of the Employment Tax Regulations provides that cash remuneration includes checks and other monetary media of exchange. Cash remuneration does not include payments made in any other medium, such as lodging, food, clothing, car tokens, transportation passes or tickets, farm products, or other goods or commodities.

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Assistant District Counsel, Indianapolis

The spreading use of arrangements designed to compensate employees with farm products and commodities circumvents the Congressional intent of extending social security coverage to agricultural workers.

The legislative history behind the initial passage of the Social Security Act of 1935 indicates that eight occupational categories, including "agricultural labor," were originally excepted from social security coverage because of the difficulties in collecting tax in the case of certain kinds of employment. Since that time amendments to the law have greatly expanded social security coverage and the FICA tax financing the system.

The Social Security Act Amendments of 1950 generally brought agricultural labor within social security and added the present exception for non-cash remuneration. However, in doing so, it is apparent that Congress was concerned about imposing burdens on farmers. Senator Walter F. George of Georgia made the following observation:

Workers on farms who are employed by one employer at least 60 days and earn \$50 or more in a calendar quarter are covered [by the 1950 amendments], and in addition, borderline agricultural workers, such as those engaged in processing and packing of agricultural and horticultural commodities off the farm, are brought under the system. These groups total about 1,000,000 persons. The committee gave careful study to the extension of coverage to workers on farms. It proposes this limited extension of coverage at this time in order to assure simplicity of administration for the farmer. There is no question but that workers on farms, including migratory workers and sharecroppers, need social security protection. The public-assistance load in the agricultural States reflect this need. To go beyond the coverage that is proposed in the bill, however, without further study of the administrative problems that would arise, would be impracticable. I regret that I am compelled to advocate delaying the extension of coverage by the bill until a thorough study of the feasibility of such coverage has been made. 96 Cong. Rec. 8491 (1950) (emphasis added).

Thus, although the language of section 3121(a)(8)(A) of the Code is unambiguous on its face, it is likely that Congress mainly intended the FICA exemption for noncash remuneration to relieve farmers from the administrative burden of accounting for and valuing de minimus amounts of noncash items ordinarily used by them to supplement the incomes of their laborers. We do not believe it was Congressional intent to apply this provision to

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noncash items that constitute a significant portion of the wages paid a worker.

Moreover, there is current authority for restricting the tax avoidance strategies built around section 3121(a)(8)(A) of the Code.

In Rev. Rul. 79-207, 1979-2 C.B. 351, a company pays its farm employees in commodity storage receipts rather than cash in order to avoid FICA taxes. The company immediately redeems the employees' receipts for cash. The value of the storage receipts is equal to the amount that the employee would otherwise receive in cash. The revenue ruling concludes that the cash value of the commodity storage receipts paid to the farm employees is, in economic reality, a payment in cash and is not excepted from wages under section 3121(a)(8)(A) of the Code.

We agree with your contention that section 31.3121(a)(8)-1(f) of the employment tax regulations and Rev. Rul. 79-207 should be interpreted to prevent the avoidance of FICA taxes through the payment of items that are "cash equivalencies." However, we believe that the revenue ruling extends this prohibition beyond mere cash equivalencies (i.e., negotiable instruments) according to the income tax accounting definition. Instead, by use of the term "economic reality," we believe that Rev. Rul. 79-207 broadly forbids the use of devices to convert what is in substance cash remuneration into other mediums of payment to avoid FICA taxation. That is, if an employer compensates his employees in agricultural commodities that are easily convertible into cash within a reasonably short time, the commodities are paid in more than de minimus amounts, and under the facts and circumstances the purpose appears to be the avoidance of FICA taxes, the transaction should be construed as a payment in cash. It is irrelevant whether the employee-recipient ultimately receives cash from his employer or from a third party, or whether he bears a risk of loss on receipt of the commodities.

If you have any further questions, please contact Mr. Thomas J. Wolf at FTS 566-3539.

JAMES L. BROKAW